

New Orders Expand

Employment Lower

Inventories Higher

Analysis by the Business Survey Committee; chairman, Robert J. Bretz, C.P.M., director of purchasing and distribution, Pitney Bowes, Inc.

The *Report on Business* is published monthly by the National Association of Purchasing Management, based on data compiled from replies to questions asked of purchasing managers in some 250 industrial companies. Membership of the Business Survey Committee is diversified geographically, based on value added by state, and by Standard Industrial Classification category, based on each industry's contribution to national income.

February Report

The strength in the economy seen in January continued in February, say the nation's purchasing managers in their latest **Report on Business**. New Orders were the up again in February, recording the highest level reached since February 1984. Production was also stronger for the second consecutive month. Inventories rose again for the third month in a row, as purchasers again reported increasing purchases in response to expanding business. On the negative side, employment fell slightly after a significant increase in January, and the speed of vendor deliveries was unchanged. Prices declined slightly in February, this marks the fifteenth consecutive month in which prices have been the same or lower.

The strength in production and the sustained growth in new orders virtually assures a good first quarter. However, the decline in the Purchasing Managers Composite Index suggests that the second quarter warrants close scrutiny," said Robert J. Bretz, C.P.M., chairman of the National Association of Purchasing Management's Business Survey Committee, and director of purchasing and distribution, Pitney Bowes, Inc.

The **Purchasing Managers' Composite Index** decreased to 50.9% in February, which is down from 52.4% in January. However, this is the sixth consecutive month this index has registered over 50%. These numbers reflect the update by the Department of Commerce of the seasonal adjustment factors used to calculate the Purchasing Manager's Composite Index. A reading above 50% generally indicates that the economy is in an expanding phase; below 50% that the economy is generally declining. The index is based on analysis by the U.S. Department of Commerce. Except for this index, the information in this report is not seasonally adjusted.

Net Difference (NET)

In each category measured, this report shows a net difference. It is the difference between the number of responses in the positive direction (higher, better, faster) and the negative direction (lower, worse, slower).

Analysis of the month-to-month difference compares the rate of change.

Employment

Employment decreased in February after a healthy rebound in January from lows in December. This lagging indicator has been in a declining trend since April 1984, as industrial employers generally continue to decrease their labor force.

Employment %	Higher	Same	Lower	Net Differ.
February	10	65	25	-15
January	12	64	24	-12
December	5	67	28	-23

Buying Policy

Lead times for production materials expanded slightly in February, which is a reflection of the higher production and new order levels. Members reported that hand-to-mouth lead times declined to 18% from 21% in January, essentially by shifting into the 30-day category. The lead time for MRO supplies was virtually the same. In the important 6-months-and-longer category for capital expenditures, the percentage fell to 51% from 55% in January.

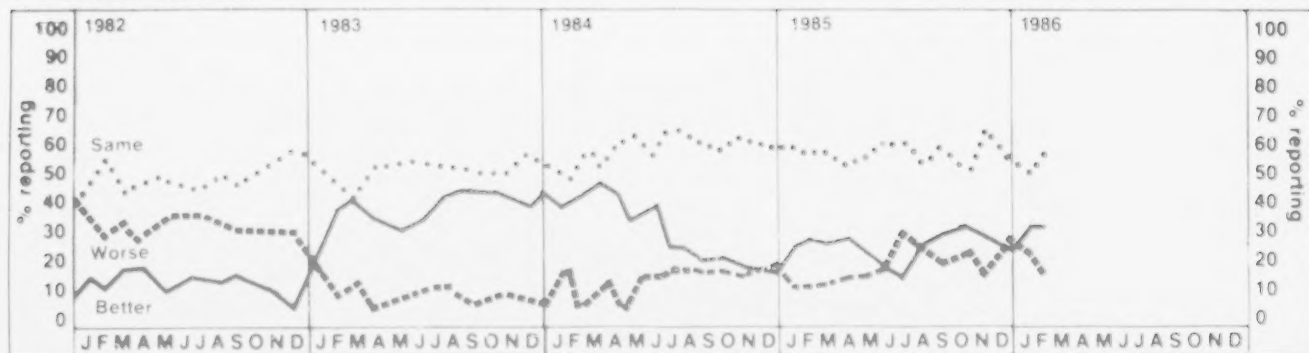
	Hand to Mouth	30 Days	60 Days	90 Days	6 Months and Longer
Production Materials %					
February	18	43	25	8	6
January	21	40	24	10	5
December	20	44	27	6	3
MRO Supplies %					
February	41	46	9	2	2
January	40	45	10	3	2
December	45	46	4	3	2

Capital

Expenditures %

February	18	4	7	20	51
January	17	3	7	18	55
December	18	2	6	23	51

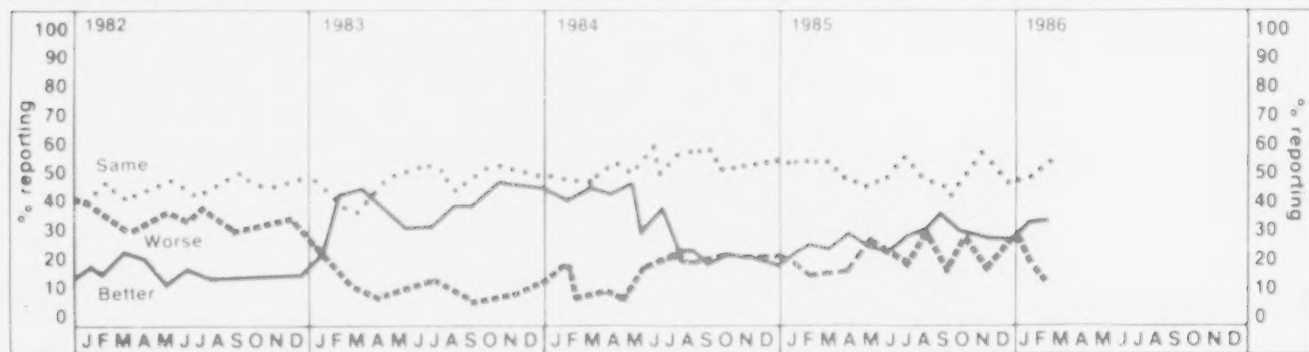
Production



January's brisk expansion in production continued in February. Although the 31% reporting better production in February was no higher than it was in January, the 15% indicating worse production is a drop of five points from January's figure of 20%. This is a healthy overall improvement.

Production %	Better	Same	Worse	Net
February	31	54	15	+16
January	31	49	20	+11
December	21	55	24	-3

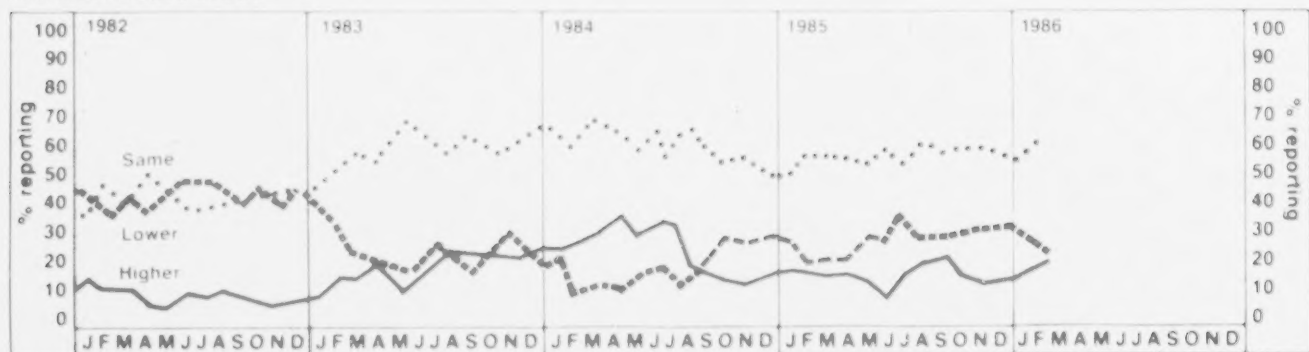
New Orders



The significant increase in the new order level in January grew even larger in February. The 35% reporting better new orders is the highest percentage since June 1984 (37%). The 12% indicating that their new orders were worse is the lowest level since that of April 1984 (6%). This strong showing all but guarantees healthy production levels in March.

New Orders %	Better	Same	Worse	Net
February	35	53	12	+23
January	34	48	18	+16
December	26	46	28	-2

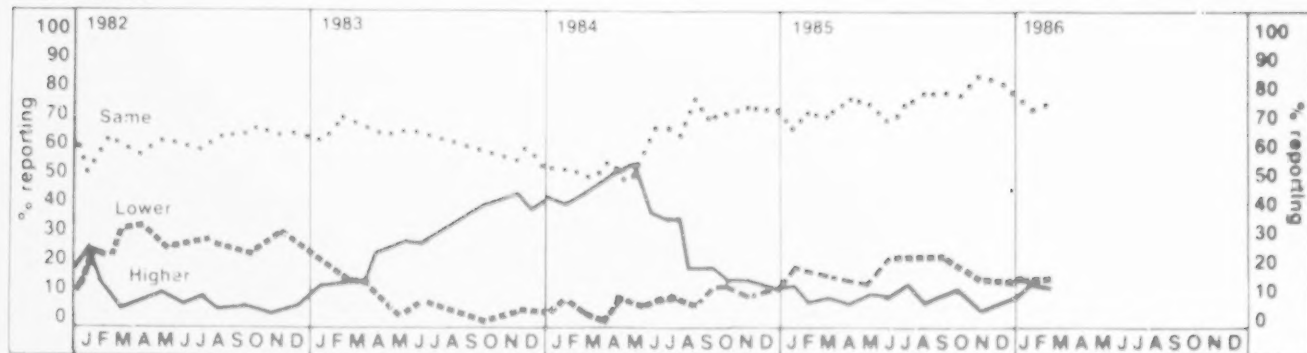
Inventories



As in January, the overall rate of decline in inventory levels slowed in February. While more purchasers reported lower, rather than higher, inventories for the eighteenth consecutive month, the net difference is now only three points. This figure mirrors the increased purchases by members over the past few months.

Inventories %	Higher	Same	Lower	Net
February	17	63	20	-3
January	15	60	25	-10
December	13	57	30	-17

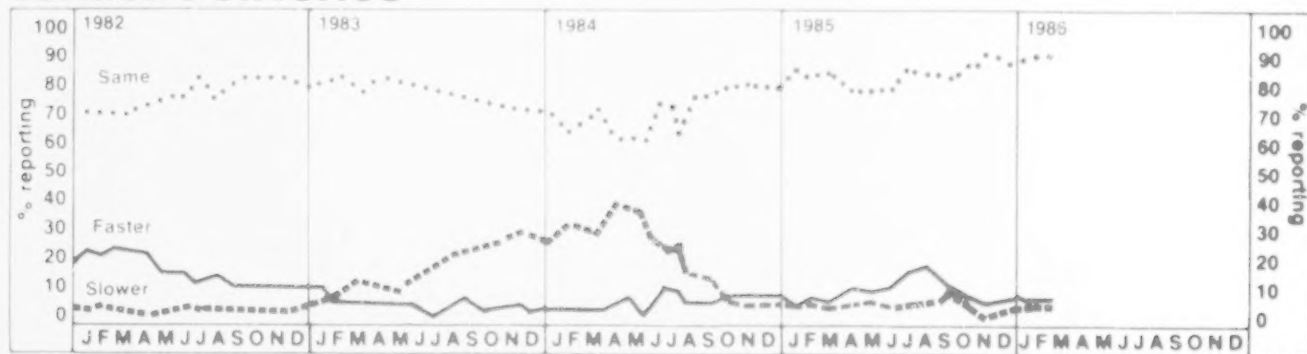
Prices



In February, purchasing managers indicated a return to the pattern of reporting a greater percentage of lower, rather than higher, prices. After thirteen months, this pattern was interrupted in January when an equal number of members reported higher and lower prices. This month's return was undoubtedly triggered by the overwhelming number of purchasers reporting lower prices for fuel oil, gasoline, and petroleum products.

Prices %	Higher	Same	Lower	Net
February	13	73	14	- 1
January	14	72	14	0
December	8	80	12	- 4

Vendor Deliveries



The speed of vendor deliveries in February is unchanged from that of January. There has been little change in vendor performance since September 1985, when the figures appear to have plateaued at current levels.

Vendor Deliveries %	Faster	Same	Slower	Net
February	5	90	5	0
January	5	90	5	0
December	8	87	5	+ 3

Specific Commodity Changes

For the thirteenth consecutive month, no shortages were reported. This time period ties the previous record of thirteen continuous months (from May 1982 through May 1983). After being reported down in price during eleven of the previous fifteen months, steel was reported up in price in February for the first time since September 1984. Virtually all petroleum products were reported lower in price in February, including all fuel oils, gasoline, and diesel fuel. Caustic Soda, used to make corrugated shipping containers, was down in price for the seventh consecutive month. Conspicuous by its absence from

the list of higher-priced commodities is corrugated containers, which were reported higher in price for the previous twelve consecutive months.

UP in Price: Steel

DOWN in Price: Fuel oil, gasoline, diesel fuel, miscellaneous petroleum products, and caustic soda (used heavily in petroleum refining and paper making)

In SHORT Supply: None

The National Association of Purchasing Management's *Report on Business* records the actual changes and rates of change in five important categories of data: production, new orders, employment, inventories, and vendor deliveries. These five components, as reported, are not adjusted to compensate for seasonal variations.

Economists have devised a variety of formulas to compensate data for seasonal variations. N.A.P.M. cooperates with the U.S. Department of Commerce, which prepares the monthly Purchasing Managers Composite Index for publication by N.A.P.M. The Department of Commerce adjusts the five above-mentioned components of the *Report on Business*, applies various weights to each, and combines them into a single index number. The Composite Index is based on analysis by the U.S. Department of Commerce, and is the only part of the report adjusted for seasonal variations.

Note: The next issue of the *Report on Business* will be available April 7, 1986.

Commodity Reports

Steel

Prepared by the N.A.P.M. Steel Committee, chairman, Daniel R. Krause, C.P.M., The Budd Company, Troy, MI

On the surface, steel buying today seems to pose little challenge. It has been a buyer's market for a long time; prices are weak, and the N.A.P.M. Steel Buyers' Group Survey for January 1986 indicates no anticipated shortages within the next six months (with a minor exception of coated steel sheets).

But something seems to be happening just below the surface that has not yet taken shape. Lead times seem to be lengthening. This could be due to declining industrial production capacity or due to reduced planned imports of foreign steel (in accordance with voluntary restraint agreements with major off-shore producers). During 1985, these voluntary agreements resulted in some reduction in the level of imports; they should have a significant affect in limiting shipments in 1986.

Also, lead times may be lengthening because of inventory building, as well as hedge buying against a potential August 1 strike at one or more domestic mills. (If no labor settlement is made in the first quarter, hedge buying will begin in earnest.) The January Steel Buyers' Survey provides some insight: 71% of the respondents reported that their inventory levels were about right; 29% said they were too high, but none indicated they were too low. Yet a growing number (from 0% in September 1985 to 11% in January 1986) indicate that they will increase inventories in the next six months, while a declining number (from 48% to 30% over the same period) indicate that they will decrease their inventories. At the same time, nearly an equal number of respondents expect an increase (19%) as expect a decrease (15%) in their industry sales and production levels.

The domestic mills will negotiate independently with the USW this spring and summer (August 1, 1986, is the contract's expiration date). The contract agreements negotiated to date include wage and work rules concessions. The terms of these settled contracts will impact significantly upon the negotiations now beginning. The union will probably grant some concessions, but will resist the deep cuts that management negotiators will seek. If there is to be a strike, an interesting question will be which, if any, company will be targeted by the union. The answers to this and other strategy questions will become clearer as negotiations proceed.

Steel buying may require some insight and imagination in 1986 in order to maintain an uninterrupted supply of steel during what may be a turbulent year. Whether due to a strike (or just the threat of one) or due to reduced supply from foreign producers (or simply the continuing efforts of the steel industry to reverse their slide by whatever means), the steel buyer must be alert this year to the vagaries of an ever-changing market. (John E. Irvine, Del Monte Corporation, San Francisco, CA)

Energy

Prepared by the N.A.P.M. Energy Committee, chairman, Howard T. Perley, C.P.M., International Paper Company, New York, NY

Crude Oil, Distillates and Gasoline

In January, spot crude oil prices fell to their lowest level in the past five years. Crude oil is running below \$19 per barrel, with predictions for declines to the \$15 per barrel level. Current supply and demand suggests that crude prices will fall until higher-cost crude production is taken off-stream, or until reduced exploration and development finally bring production in line with demand. Crude oil prices will fall in 1986 (perhaps by \$2 to \$5 per barrel), but should not completely crash. It always seems that a few producers band together and keep the market from completely crashing. This reduction will carry through to all products. By mid 1986, gasoline prices can be expected to be at least 10¢ per gallon below 1985 levels. (J.H. Kedrowski, Aluminum Company of America, Pittsburgh, PA)

Coal

The 1986 outlook for coal production and consumption almost duplicates that of 1985. While 1986 consumption is projected to increase by approximately 2%, production capacity is still far greater. Inventory reductions continue. U.S. utilities still have approximately 160 million tons stockpiled, representing approximately an 81-day supply. Thus, many consumers will continue to buy less than they use over the next six months. Lower petroleum and natural gas prices are pressuring coal prices in some areas of the country. This supply-demand situation dictates a continued use of the spot market in the near future as opposed to long-term contracting. Continued attention to coal

transportation rates, and to the possibility of making transportation contracts, is suggested. (W.T. Robertson, Jr., C.P.M., Duke Power Company, Charlotte, NC)

Natural Gas

There is considerable confusion in the transportation of end-user-owned natural gas. Only Columbia Gas Transmission, Columbia Gulf, and El Paso have announced that they will be nondiscriminatory transporters after February 15, 1986. Many other pipelines are expected to transport under the new FERC rules before the end of 1986, enabling both large and small industrial users to make lower-priced gas purchases directly from the producer. All users will thus be assured of equal access to interstate transportation. Local distribution companies (LDCs) will also be able to purchase directly from the producer, which should result in lower overall gas prices for industrial, commercial, and residential consumers.

These opportunities (and risks) will be explored in depth at the Energy Committee's May 6th luncheon (code SE) at N.A.P.M.'s International Conference in Atlanta. The luncheon topic will be "Purchasing Natural Gas in 'Open Access Markets'" (R.W. Lauer, PPG Industries, Inc., Pittsburgh, PA)

Electricity

Will the U.S. experience electricity shortages in the 1990's? Yes, say analysts, who note that it is nearly ten years since the last order was placed for a new commercial nuclear plant in this country. No, say those who compare forecasts of electricity demand with utility generating capacities.

Accurate forecasting of future peak electricity requirements is vitally important. Ten years ago, utilities were expecting average electricity demand to grow 7% annually over the following ten years. Actual growth was less than half that, which is why so much excess generating capacity exists today.

For the next ten years, utilities are currently forecasting average demand to grow less than 2.5% annually. If this projection proves correct, reserve generating capacity in 1996 should be adequate, both nationally and regionally. However, if peak demand growth is significantly greater than projected, electricity shortages could develop, as it now takes over ten years to build large power plants. Smaller, high-efficiency, modular coal-fired generating plants may be the solution. (Ian G. Mackenzie, C.P.M., Corning Glass Works, Corning, NY)